

1-19-2011

# Outsourcing Logistics Can Help Small Businesses Compete

Stephen M. Rutner

Follow this and additional works at: <https://digitalcommons.georgiasouthern.edu/savannah>

---

## Recommended Citation

[http://coba.georgiasouthern.edu/pdf%20files/2011\\_01\\_19\\_Rutner\\_Outsourcing\\_Logistics.pdf](http://coba.georgiasouthern.edu/pdf%20files/2011_01_19_Rutner_Outsourcing_Logistics.pdf)

This article is brought to you for free and open access by the Business, College of - College Publications at Digital Commons@Georgia Southern. It has been accepted for inclusion in Business in Savannah Articles by an authorized administrator of Digital Commons@Georgia Southern. For more information, please contact [digitalcommons@georgiasouthern.edu](mailto:digitalcommons@georgiasouthern.edu).

# Tax man may be coming for 'last-in-first-out' users

In the near future certain businesses could be saddled with higher tax bills as a result of how they account for inventory.



**Michael Rundbaken**

There are different methods of accounting for inventory but the one getting the most attention these days is the LIFO method. LIFO is an abbreviation for "last-in-first-out."

This is opposed to the other common inventory accounting convention, FIFO for "first-in-first-out."

LIFO has been around since the 1930s and has a financial reporting conformity requirement that makes the use of LIFO for financial reporting a condition of its use for tax purposes.

Wholesalers, retailers, manufacturers, automobile and equipment dealers and a wide range of other businesses use LIFO.

In essence LIFO is a tax deferral allowing businesses that have elected the method

In consecutive budget proposals, the Obama administration has proposed ending the use of LIFO (as an inventory accounting method) for federal income tax purposes and requiring users to recapture historic LIFO reserves into income. These reserves would be recaptured into taxable income ratably over 10 years.

to potentially defer the inflationary gain on inventory purchases indefinitely.

As long as inventory levels are steady or growing, the taxpayer never is deemed to have sold any of its older, lower-cost inventory. As with all tax deferrals, the tax man will come sooner or later to get paid.

If inventory prices or levels fall, businesses will be deemed to have sold some units purchased in a prior period, and the deferred inflationary gain in those periods will be recognized in taxable income.

In the meantime, another attempt to tax these deferred gains has emerged.

In consecutive budget proposals, the Obama administration has proposed ending the use of LIFO for federal

income tax purposes and requiring users to recapture historic LIFO reserves into income.

These reserves would be recaptured into taxable income ratably over 10 years. According to the budget proposal, repeal of LIFO would bring in approximately \$59 billion in tax revenue.

But ending LIFO may not prove so simple. Many people defend LIFO as a proper method for tax purposes, arguing that it provides for a matching of income and expenses.

They say that to the extent prices are increasing because of inflation, the LIFO method ensures the higher-price inventory gets included in costs of goods sold while matching that amount with the current revenue, which

leads to a better reflection of income.

Plus, LIFO repeal would result in recognition of taxable income with no economic income, meaning taxation without receipt of dollars. This could be a difficult pill to swallow for many businesses.

Regardless of whether Congress enacts the White House proposal to repeal LIFO, another threat to LIFO's survival is lurking.

The accounting method would be eliminated under the pending framework of international financial reporting standards (IFRS) that would take effect if the United States adopts IFRS.

The seemingly inevitable shift from GAAP to IFRS raises the issue of whether companies will be able to continue using LIFO for tax

purposes in light of the conformity requirement.

Simply doing nothing to change the conformity requirement would result in a tax increase without Congress or the White House having to actually vote for or sign one into law. With the ever-increasing deficit, this could be an appealing outcome for lawmakers.

So what does this all mean?

Companies using the LIFO method need to pay close attention and plan for a potential tax bill.

For companies deciding whether to use the LIFO method, this is a reminder that all accounting method elections require careful consideration to ensure all facets of the decision are considered.

If you are considering a LIFO election or would like to know the tax consequences if you are forced to take your LIFO reserve back into income, you should consult your financial advisor.

Michael Rundbaken, CPA works at Hancock Askew & Co. LLP and can be reached at 912-234-8243 or [mrundbaken@hancockaskew.com](mailto:mrundbaken@hancockaskew.com).

# Outsourcing logistics can help small businesses compete

Every successful company has a core competency. It might be retailing, financial management, food preparation, etc.



**Stephen M. Rutner**

To get ahead in today's competitive business environment, you need to be better than the other guy at something. So, the question becomes

is that something outsourcing logistics could help with?

Most companies don't do a good job at logistics. If you are a world-class oil refinery, why would you believe you are a world class logistician, too?

Even if your company is good at logistics, do you want to spend time, effort and capital on logistics that your organization could invest improving your true core competency?

These are realistic questions every organization needs to evaluate. The truth is your company may or may not benefit by outsourcing your logistics needs.

The first step is to identify

whether your organization is a viable candidate to outsource.

Most people mistakenly assume you have to be a Fortune 500 type company to make this work. There is some validity to the concept that larger companies are more likely targets for logistics outsourcing.

The truth is that the largest organizations often have highly skilled internal employees doing their logistics and do not gain much benefit by outsourcing. Small organizations often can benefit from outsourcing specific tasks or skill sets. So size should not preclude a company from making a pragmatic evaluation of its logistics outsourcing needs.

Therefore, your company needs to identify a number of critical items to determine the viability of logistics outsourcing.

The goal is to identify how much your organization spends on logistics and how important it is to the overall success of the company. If you spend less than \$200,000 in transportation and inventory, you are not going to be a high priority target for Third Party Logistics, or 3PL, companies.

However, you may need

Approximately 90 percent of companies that outsourced reported the relationship was either successful or somewhat successful.

niche services that may be outsourced. One benefit of this step is that it identifies whether your logistics process is working. Many companies cannot answer the questions about cost and impact. This is a valuable step for any organization to evaluate their overall business process.

Next, you need to evaluate how well your organization is performing the logistics functions. There are many benchmark tools and datasets. However, answers to a number of basic questions can help you form a reasonable basis for consideration.

These include:

- Do you have overly full warehouses or frequent stockouts/expedited shipments?
- Do your customers cancel orders/back orders?
- What is your fill rate on shipments?
- How often do you turn your inventory?
- Do you experience stock-

outs on inbound shipments?

• Do you have a scorecard for your transportation providers?

• How many transportation companies do you employ?

These are simple questions that indicate overall effectiveness of your logistics areas.

If you are doing a good job in the areas above, you may not benefit greatly from outsourcing. However, most companies rapidly identify areas that need drastic improvement.

Therefore, it is likely time to start shopping for a logistics provider. This is a challenging process but an important step. You will be entering into a mid- to long-term relationship with another company to perform your internal logistics functions.

You should demand that any 3PL that solicits your business provide answers on how it is going to achieve these benefits: cost reduction, increased operational flexibility, enhanced internal logistics expertise,

better customer service and improved capital management.

The downside of the outsourcing process is that it is not popular with current employees and can result in a loss of internal logistics control.

The overall impact of this decision can result in your company gaining additional competitive advantage.

You need to consider the choice carefully and make a smart-business-process driven decision.

The good news is that a recent study of 3PLs found that approximately 90 percent of companies that outsourced reported the relationship was either successful or somewhat successful. Only 10 percent had a negative experience.

The overall impact is that your company should consider logistics outsourcing and may benefit if it fits your organization's need.

Stephen M. Rutner is a professor of logistics and intermodal transportation at Georgia Southern University and director of the Ph.D. program in logistics/supply chain management. He can be contacted at [srutner@georgiasouthern.edu](mailto:srutner@georgiasouthern.edu).